Income Taxes

Modern American Law Lecture

Blackstone Institute, Chicago

INCOME TAXES

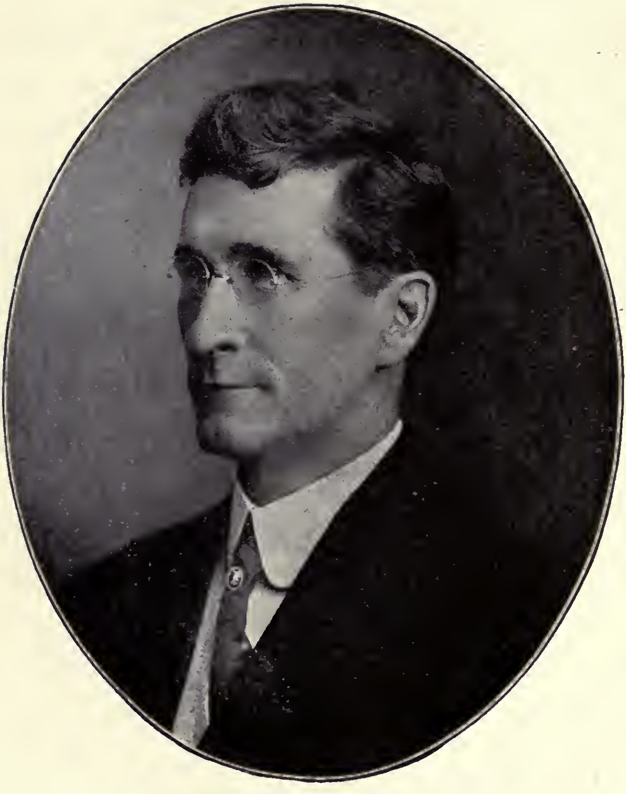
BY

Hon. THOMAS E. LYONS, A.B., LL.B.

MEMBER WISCONSIN TAX COMMISSION

One of a Series of Lectures Especially Prepared for the Blackstone Institute

BLACKSTONE INSTITUTE
CHICAGO



THOMAS E. LYONS

THOMAS E. LYONS

The author of this article was born and raised on a farm in Wisconsin and has always resided in that state. After the usual training in the district and high school he entered the University of Wisconsin in 1882, graduating from the College of Letters in 1885. For the next four years Mr. Lyons served as county superintendent of his native county and then returned to the Law School, from which he received the degree of LL.B. in 1890. For the next twenty years he was engaged in the general practice of law at Superior, Wisconsin, during which time he served successively as school commissioner, library director and city attorney. In 1911 he was appointed a member of the Wisconsin Tax Commission and still holds a position on that board. He has written several articles on various phases of taxation.

The Wisconsin Tax Commission has supervision over the assessment of the general property of the state and exclusive jurisdiction over the assessment of public service companies and administration of the income tax. Wisconsin was the first to demonstrate that a state income tax law can be successfully administered. Mr. Lyons' legal training and intimate acquaintance with the subject of taxation in general and particularly with the practical operation of federal and state income taxes is a sufficient guarantee that the reader will find the following pages both interesting and authoritative.

INCOME TAXES

By

THOMAS E. LYONS, A.B., LL.B.

INTRODUCTION

Taxation under legislative control is a comparatively modern development. In the early stages of society there were no taxes and the gifts later paid to tribal chiefs were of a personal rather than of a public nature. Even the services rendered to the lord paramount or to the king in feudal times were in the nature of compensation for protection furnished or for the use of a freehold and not taxes in the proper sense. The nearest approach to taxes under the feudal order was the payment made in money as commutation for feudal services. In time these exactions came to be looked upon as taxes and became the subject of great abuse. One of the important guaranties of Magna Charta is that "No scutage or aid shall be imposed on our realm save by the common council of our realm." King John was stripped of all his power to impose these burdens except as to the three customary feudal aids of contribution in the case of the king's captivity, on the knighthood of his eldest son and on the marriage of his eldest daughter. The Declaration of Rights in 1689 provided that the "levying of money for or to the use of the crown by pretense of prerogative with-

out grant of parliament for longer time or in other manner than the same is or shall be granted is illegal." We have here the beginning of legislative control over taxation and this provision the historian Green declared "to be the greatest constitutional change which our history has witnessed." From that time forward there has been a constant effort among organized governments to apportion public expenditures according to the taxpayer's ability to pay, and the income tax marks the latest step in the evolution of that effort.

The first attempt in this direction was the poll or capitation tax. In primitive society, when everything was produced by individual exertion and private property had but slightly developed, the head or poll tax formed a fairly satisfactory basis of taxation. But with the development of private property differences in economic conditions began to appear and the poll no longer constituted a proper unit for the distribution of public burdens. As the defects in the poll tax came to light, attention was directed to product as the test of ability and for a time taxes were imposed accordingly. As the product from different classes of property and from the same class under different conditions varied from time to time, it became necessary for the purpose of stability to estimate by outward signs and often in advance. The extent of land holdings, the character and size of dwellings, stores and factories and at one time the number of windows in houses were used as the measure of the tax. These capricious tests often resulted in hardship and led to the selection of expenditure

as the basis of contribution to public burdens. But it soon developed that expenditure failed to distinguish between the spendthrift and the miser and the relatively greater expenditure, in proportion to ability, of the poor than the rich. Of necessity industrial classes spend most of their earnings for self-support whereas the wealthy can live handsomely on a meager fraction of their incomes. In due course this test of ability also fell into disfavor.

GENERAL PROPERTY TAX

The increasing difference between those who owned property and those who did not gradually led to the selection of that test as the basis of taxation, and ultimately produced the general property tax. This being the prevailing system of taxation during the formative period of our history, it was adopted by all the American states and still constitutes the framework of their tax systems. In 1912 it was estimated that the property tax produced not less than 75 per cent. of all our public revenue.

Under this system taxes are distributed according to the value of property owned by the different members of the community. While property was simple in character and limited in quantity and the duty of the assessor was to measure, weigh and count, this test proved fairly satisfactory. But as industry and commerce developed and new forms of personal property came into being, the difficulties of administration increased and the relative equality disappeared. The property tax at its best lacks elasticity; it falls upon the owner in his losing as well as in his prosperous

years, and applies with equal severity to productive and unproductive property. These considerations soon led to widespread dissatisfaction with the general property tax and it has been either abandoned or greatly subordinated in all parts of the world except in the United States.

The radical defect in all these methods of taxation was their utter failure to recognize and provide for differences in social and economic conditions. The inequality between the rich and poor was ignored by the capitation tax, and the difference in the degree of productiveness was ignored by the property tax. The products tax took no note of the relative expenditures required to produce the yield, and the consumption tax offered a premium to the penurious rich while it penalized the improvident poor. Neither of these systems took note of the varying degrees of indebtedness of the person charged with the tax. Obviously a more accurate test was needed and was thought to be found in the income tax. Considered from this standpoint as Professor Seligman states, "There is no doubt that taking it by and large the income tax more accurately responds to modern demands than any of the preceding tests."

INCOME TAX DEFINED

An income tax is a direct levy by a government upon the income of individual citizens whether that income is received from labor, industry, investment, real estate or any other source, computed annually or at stated intervals, Bliss, Encyclopedia of Social Reform, 600. It is in effect a tax based upon and

measured by the earnings of person or property, or of both combined.

Income taxes differ from property taxes, which are either imposed upon property direct and become a lien thereon, as in the case of real estate, or are made a charge against the person by reason of ownership, as in the case of personal property, regardless of productiveness except as that element may be reflected in market value. They differ from occupation and other excise taxes, which are exactions for engaging in particular lines of business or in an ordinary line of business in a particular way; and they differ from consumption taxes, which are measured by expenditure.

Income taxes are not levied upon property nor upon the operations of trade and business, or the persons employed therein; nor upon the practice of a profession or the pursuit of a trade or calling. They are taxes levied upon the acquisitions arising from one or more of these sources. Ordinarily the tax is based upon the excess of such acquisition for a given period over a certain minimum sum called an exemption. They are, therefore, taxes upon the periodical accretions produced by personal effort or from the use or disposition of property or of all of these combined.

DEVELOPMENT OF INCOME TAX

As might be expected, the first attempts to apply the principle of income taxation were crude and ill-considered, and the income tax in its present form is the growth of many years. During the early middle ages salaries were some times taxed, and as trade and

commerce developed a rough attempt was made to measure the gains of business and impose a tax accordingly. But in all these cases the income was estimated and largely measured by the property possessions of the taxpayer and his apparent rather than his actual ability. The mediaeval system therefore was but a slight modification of the property tax, supplemented by a charge against the business man and the laborer. While ability is continually mentioned as a test during this period, an examination of the laws will disclose that property or product instead of income was generally made the criterion.

In Italy.—As the Italian cities developed into centers of industry and trade in the middle ages, a determined effort was made to reach the great fortunes accumulated by merchants and traders. Florence devised a scheme of taxation, called the *estimo,* based upon the estimated wealth and ability of the taxpayer. About the middle of the fifteenth century the *estimo* gave way to the *catasto,* which was soon after made progressive under the name of the *scala,* with many of the characteristics of the modern income tax. With the restoration of the artistocratic régime in the sixteenth century both the *catasto* and *scala* were replaced by a family tax, again shifting the burden to the poor.

In France.—The history of taxation in France presents many of the same characteristics. The *taille* was but a modified form of the English *tallage,* originally computed according to the amount of land but later modified by considerations of ability to pay. In 1710 Louis XIV enacted the so-called *dixieme,* or

tenth, based on product and property, corresponding to the tithes of biblical times, and the tenth and fifteenth in England during the middle ages. The *dixieme* continued in force until the revolution but the classes to which it applied secured so many modifications and exemptions that both its equality and producing power were greatly impaired. The development of trade and industry in the eighteenth century stimulated the effort to tax profits derived therefrom in both France and England, but in neither case did the means employed attain the characteristics of the modern income tax.

In England.—The demands of the Napoleonic wars called for a revision of the English fiscal system and in 1798 the aid and contribution act, or triple assessment, was passed under the leadership of Pitt. This law was designed to distribute the tax burden according to the taxpayer's general ability, as measured by both property and income. While the tax provoked most violent opposition, the increasing yield, from two million pounds the first year after its enactment to nearly sixteen million pounds in 1815, gained it favor as an emergency measure and the merits of the income tax have been universally recognized from that day forward. But the triple assessment was not an income tax in the modern sense and it was not until 1842 that England permanently adopted the system of income taxation. The act of that year was presented by Sir Robert Peel to compensate for the loss of revenue resulting from repeal of the corn laws, with the express understanding that it was to be a temporary measure. But the gradual recognition

of the merits of the system, coupled with the increasing needs of the empire for public revenue prevented even Gladstone, in his day of power, from repealing it. It may be said, therefore, that the Peel act is the parent of all modern income taxes, and that the development of the system as now known is the growth of the last half century.

In Germany.—Feeble and sporadic attempts to tax income began in Germany in 1820 and were continued between 1848 and the Franco-Prussian War. It was not until 1891 when the Prussian income tax was enacted that the system in its modern form was introduced into that country. The Prussian law followed the English income tax in its main features but provided more positive and arbitrary means of assessment and made less use of the effort to collect at source. The increasing demand for revenue and the success of the Prussian income tax led to its general adoption in the other states of Germany. In 1910 twenty-one of the twenty-six states of that country and many municipalities had adopted the system. An imperial tax was imposed in 1913, and since the present European war broke out all the belligerent countries have further availed themselves of the system.

In the United States.—The taxation of incomes had never been generally adopted in this country prior to 1913. In several of the colonies the principle was utilized prior to the adoption of the constitution but not in its modern form. A federal income tax act was enacted to meet the demands of the Civil War in 1862 which continued in force until 1871. The law was

modified and the rates increased from time to time resulting in a yield of $73,434,709 in 1866 and an aggregate of $376,290,600 during the entire period of its existence. A general income tax law was enacted by Congress in 1894 but it was held void by the supreme court because a direct tax, within the meaning of the constitution, and not levied according to population and representation in Congress, as provided by Article I of that instrument, Pollock vs. Farmers Loan & Trust Co., 157 U. S. 429; 158 U. S. 601. As the result of this decision steps were taken to amend the constitution so as to provide for the taxation of incomes relieved of the restriction that the apportionment be made according to population, followed by the adoption of the sixteenth amendment by the requisite number of states in 1913. In 1909 Congress provided for an excise tax of one per cent. on the net income of corporations, which was in effect an income tax as to them and was later sustained by the supreme court in the case of Flint vs. Stone Tracy Co., 220 U. S. 107. The adoption of the sixteenth amendment expressly authorizing the taxation of income, followed by federal act of 1913 and the revision of 1916, marks the first step toward the permanent adoption of income taxation in this country.

In the American States.—In the meantime about twenty states had experimented with an income tax in one form or another. Several of the Atlantic and Southern states resorted to this means of raising revenue about the middle of last century and the system was extensively used by the states of the Con-

federacy during the Civil War. But few, if any, of these enactments provided for the taxation of all forms of income. As a rule they were confined to the taxation of income, derived from sources not otherwise taxed, such as salaries, fees, commissions and profits derived from the purchase and sale of property.

SPREAD OF THE INCOME TAX

As pointed out by Professor Seligman, during the last quarter of a century there has been a strong trend toward the system of income taxation. Congressman Hull, in presenting the 1913 income tax bill to Congress, said:

> During recent years there has been a general agitation and demand in almost every state in the union and in almost every country in the world for intelligent, fair and practical reforms and readjustments of their tax systems to the end that every citizen may be required to contribute to the wants of the government in proportion to the revenue he enjoys under its protection. To this end the doctrine of equality of sacrifice or ability to pay is being universally invoked.

President Wilson in his message to Congress in December, 1915, declared that "We should be following an almost universal custom of modern governments if we were to draw the greater part or even the whole of the revenues we need from income taxes." The growing appreciation of the merits of this method of taxation, coupled with the increasing demand for public revenue, has led to the widespread adoption of the income tax and it now forms part of the fiscal system of every civilized country in the world.

In one form or another income tax laws are now

in successful operation in England, Germany, France, Belgium, Denmark, Norway, Sweden, Holland, Italy, Switzerland, Hungary, India, Japan, Russia, Hawaii, Canada, New Zealand, Australia and the United States, or in some of the states, provinces or political subdivisions of these countries. These several laws differ from each other in many respects but they all agree in making income the basic principle and measure of the tax paid. Consideration of the details of these various laws is beyond the limits and purpose of this lecture and for that reason the discussion is confined to the laws of England and the United States, among national measures, and to those of Wisconsin and Massachusetts among the states, with only incidental reference to others. It is believed that these income tax laws are typical of all others.

RIGHT TO ADOPT INCOME TAX

The power of taxation is an attribute of sovereignty, inherent in every government unless denied by its constitution. This power is legislative in character and may be exercised upon all persons, property, privileges and occupations subject to legislative control, 1 Cooley on Taxation, 7; McCullough vs. Maryland, 4 Wheat. 316. The American states as independent sovereignties, also possesss this power except as limited by the federal constitution, Michigan Central Ry. vs. Powers, 201 U. S. 245, and as above stated many of them have exercised it by attempting to tax incomes. This form of taxation is now in force in the states of Massachusetts, Connecticut, Virginia, South Carolina, Oklahoma, West Virginia and Wisconsin.

Numerous expressions may be found in court decisions to the effect that no state can tax income derived from interstate commerce, Steamship Co. vs. Pennsylvania, 122 U. S. 326. But the courts have repeatedly held that property engaged in interstate commerce may be taxed by the states provided that a reasonable basis of apportionment be used to ascertain the value of the property within their borders. Why should not the same rule apply to income? If one state may not tax income from interstate commerce, no other can do so, and the result would be a legal no man's land, where vast organizations may operate relieved from the burdens which others are compelled to bear. Of course neither property nor income from interstate commerce should be singled out for discrimination, or subjected to excessive taxation; but no reason is apparent why they should escape their proper share of the common burden.

In the assessment of railroad and other interstate property under the property tax, the common practice is first to ascertain the value of the entire property as a unit and then apportion such valuation among the several states according to mileage, gross or net earnings, or a combination of these factors. In the administration of the Wisconsin income tax law the same principle has been applied to the assessment of income from business conducted in several states. The entire income from all sources is first ascertained as a unit and then distributed to Wisconsin in the proportion which the property located and business transacted in that state bears to the total property and business of the company. The United

States Supreme Court has never directly passed upon the question, but an assessment made in this manner was upheld by the supreme court of Wisconsin in the case of United States Glue Co. vs. Town of Oak Creek, 161 Wis., 211, and it is believed that the practice is warranted by existing law. If the right of the states to tax income from interstate commerce is doubtful or uncertain, Congress has unquestioned authority to confer it upon them.

Another limitation growing out of the dual nature of the federal and state governments is the lack of power on the part of either to tax the agencies or instrumentalities employed by the other in carrying on its governmental functions. Thus it was held under the civil war income tax law that the United States could not tax the salary of a judge of a state court (Collector vs. Day, 11 Wallace, 113) and, conversely, that a state could not tax the salary of an officer of the United States Government, Dobbins vs. Commissioners of Erie County, 16 Peters, 435; Purnell vs. Page, 133 N. C. 125. The same principle prevents a state from taxing income from United States bonds, and the United States from taxing income from bonds issued by a state or any of its political subdivisions. Express exemptions to this effect are contained in the recent federal act and in the Wisconsin and Massachusetts laws. Both the federal government and the separate states may tax the salaries of their own officers if the legislature so provides and it is common practice to do so as to all officers elected after the enactment of the law. The right to tax the salary of a circuit judge elected prior

to the passage of the income tax law has also been upheld, State ex rel Wickham vs. Nygaard, 159 Wis. 396.

SCOPE OF INCOME TAX LAWS

Subject to these limitations the several states are as free to adopt income tax laws as the federal government. In doing so they may apply the tax to all income received by their own residents, or to all income derived from sources within their borders. The former is the more common practice. Thus the federal income tax law expressly provides for the taxation of all income received by citizens of the United States, including that derived from foreign countries, and also so much of the income of non-residents or aliens as is derived from business transacted or property located in this country. The English and German income tax laws are to the same effect. The recent Massachusetts income tax law makes residence the test of taxability and, with perhaps greater consistency, confines the tax to income received by residents of that state, excluding income derived by non-residents from sources within the state. The Wisconsin law makes the source of income the test and limits the application of the tax to income derived from property located and business transacted within its borders, whether by residents or non-residents.

Even where the source of income is made the test of taxability, compensation for personal services, interest from securities and dividends from stocks are taxed at the residence of the recipient under the rule of *mobilia sequuntur*. The close commercial relations

and the principle of comity between the states stand in the way of one state taxing all income of its own residents and also that of non-residents derived from sources within its borders, as is done by the federal statute. To do so involves an inconsistency and if all states were to adopt a system of income taxation it would result in double taxation of all income derived from one state and paid to residents of another. The Massachusetts rule making residence the sole test of taxability and excluding income passing to non-residents from sources within the state, is believed to be simpler and more consistent.

In discussing a similar question in a recent article Professor Bullock expressed his preference for that system in the following words:

> If every citizen were taxable at his domicile upon his entire income without exemption or deduction, except such as may be proper in the case of small incomes, and if then all tangible property were taxed, under a proper classification, at its situs, we should have the simplest, most logical, and most satisfactory of all solutions. Everybody would pay an income tax in the locality where he lives and enjoys the benefits of government, and all property would contribute to the support of the jurisdiction where it receives the benefit of governmental services. The former tax would necessarily be of a personal character, the latter would be levied purely objectively upon things without regard to ownership.

WHAT IS INCOME?

In framing or construing an income tax law the first question to arise is, what is or may be classified as income? Does the term include all that comes in during a given period from whatever source, or is it confined to earnings of person and property, or a

combination of these? Are sporadic gains, such as gifts and inheritances, or appreciation in the value of property, income? Does the term include proceeds derived from the sale of products which diminish and eventually exhaust capital, such as the sale of ore from mines, or standing timber from lands? Can it be applied to payments received under an annuity or an insurance policy, or to a stock dividend? If some or all of these are to be treated as income, to what extent are deductions to be allowed for impairment of capital? These and many similar questions confront the legislator or administrator in dealing with this form of taxation.

The Century Dictionary defines income as "that which comes in to a person as payment for labor or services rendered in some office or as gain from lands, business, the investment of capital, etc.; receipts or emoluments regularly accruing either in a given time or, when unqualified, annually."

Professor Seligman says:

> Income is that which comes in to an individual above all necessary expenses of acquisition and which is available for his own consumption. Since the income is a flow of wealth it must always be estimated for a definite period so that when we speak of income for purposes of taxation we really mean annual income. Strictly speaking, income as contrasted with capital denotes that amount of wealth which flows in during a definite period and which is at the disposal of the owner for purposes of consumption so that in consuming it his capital remains unimpaired. *Seligman on Income Tax, 19.*

The supreme court of Georgia expressed this distinction figuratively in a much quoted paragraph as follows:

The fact is, property is a tree, income is the fruit; labor is a tree, income the fruit; capital a tree, income the fruit. The fruit if not consumed as fast as it ripens will germinate from the seed which it encloses and will produce other trees and grow into more property; but so long as it is fruit merely and plucked to eat and consumed in the eating, it is no tree and will produce itself no fruit. *Waring vs. City of Savannah, 60 Georgia 93.*

It will be seen from the foregoing that "income" implies something apart from and in addition to capital recurring at stated intervals. As stated by President Hadley the conception underlying capital is static and independent of time while the conception underlying income is dynamic and involves the element of time. In other words, capital is constant and fixed while income is mobile and recurrent. An income tax is designed to reach and apply to the income only leaving the capital unimpaired.

Fortunately, as said by the supreme court of Wisconsin, "we are not called upon to enter the wide and somewhat vague field of what the term 'income' means in the technical or true economic sense of the word. Income as used in constitutions and tax statutes must be given its common ordinary meaning and not its strict technical or economic meaning," Van Dyke vs. Milwaukee, 159 Wis. 460.

For the purpose of an income tax the proper definition of the word would be "all that a man receives in cash during the year except such sums as are merely capital or principal in a changed form, that is, excluding sums which are merely the proceeds of some other form of capital converted into cash. *Black on Income Taxes, Section 221.*

The use of the word "cash" unduly limits the above definition. Income in its general sense need

not necessarily be money. It must be money or that which is convertible into money, Income Tax Cases, 148 Wis. 456. The rental value of residence property occupied by the owner, the value of farm produce consumed by the occupant, and the value of supplies from a merchant's stock used by his family, are treated as income under nearly all income tax laws, Corke vs. Fry, 32 Scottish Law Reports, 341.

Most modern income tax laws use the words "gains and profits" in addition to "income" in declaring what the tax shall apply to. The recent federal income tax law is typical in this respect in declaring that:

> The net income of a taxable person shall include gains, profits and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or out of interest in real or personal property; also from interest, rent, dividends, securities or the transaction of any business carried on for gain or profit, or gains or profits and income from any source whatever.

ACCRETION TO CAPITAL

Bearing in mind that capital is to remain intact, it is plain that the proceeds derived from the sale of a farm, a factory, or a mine without profit, represent a mere change in form or conversion of capital assets, and not income in the proper sense. Under early income tax laws the tendency was to limit the term "income" to profits derived from personal or business activity and to credit appreciation of assets to capital account. Accordingly some early decisions held that appreciation in the value of property should

be treated as addition to capital. Thus the supreme court of the United States in the case of Gray vs. Darlington, 15 Wallace 63, said "the mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advances in value in no sense constitute the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital." In the light of subsequent decisions it is believed that this language is too broad. The sole question involved in that case was as to whether the increase in the value of corporate stock held for a period of years could all be ascribed to the year in which the stock was sold. The court properly held that it could not, but the point as to whether so much of the increase as accrued during the year of the assessment or after the income tax law was enacted was not involved and the decision cannot be considered as authoritative on that point.

The recent decision of the United States Supreme Court in the case of Von Baumbach vs. Sargent Land Company, 37 Supreme Court Reporter 201, holding that royalties received by an owner of mineral land for mining and extracting ore therefrom constitute income under the Corporation Act of 1909 and are taxable as such without allowance for depreciation, and the English case of Alianza Company vs. Bell, 1 Kings Bench 184, to the same effect indicate a relaxation of this rule. And this is the tendency of the more recent decisions, Jarvis on British Income Tax.

Both the income tax acts of 1913 and 1916 expressly

provide for the taxation of profits from capital assets when realized in sale and the Wisconsin and Massachusetts income tax laws have similar provisions. The tax, however, applies only to so much of the profit as accrued after the income tax law was enacted. Whatever property or thing of value the taxpayer had at that time is treated as capital for the purpose of determining the tax. If the property were purchased prior to and the sale occurred after the enactment of the income tax law, then only so much of the profit can be subjected to the tax as accrued during the life of the law, State ex rel. Bundy vs. Nygaard, 163 Wis. 307. If the value of the property at the time when the law took effect can be definitely determined, then the profit will be computed on that basis. In the absence of such proof of value the federal act of 1913 and the Wisconsin law provide for a pro-rating of the profit in the proportion which the time between the enactment of the law and the date of sale bears to the total length of time the investment was held. Both methods are designed to determine how much of the profit accrued after the enactment of the law and to confine the tax to that amount. Practically all authorities agree that no part of the increase in the value of capital assets which accrued prior to the enactment of an income tax law can be assessed as income. To do so would give the law a retroactive effect.

DISTRIBUTION OF SURPLUS

Another form of the same question arises when a corporation distributes a surplus accumulated prior

to the enactment of the income tax law to its stockholders after the law takes effect. Clearly such a surplus cannot be taxed to the corporation direct because there was no income tax law when it was earned. Is the same fund taxable when distributed to stockholders in the form of dividends? The supreme court of Wisconsin answered this question in the affirmative in the case of Van Dyke vs. City of Milwaukee, *supra,* on the ground that earnings of a corporation are not income to stockholders until distributed, but that such dividends become income to them when received.

A different conclusion was reached by the circuit court of appeals for the Eighth Circuit in the case of Lynch vs. Turrish, 236 Federal Reporter, 653. It was there held that all surplus on hand when the act of 1913 took effect represented capital and that the same could be distributed to stockholders free of the tax. Notwithstanding this decision the internal revenue department in administering the act of 1913 continued to tax dividends declared out of surplus in harmony with the Wisconsin rule, but the 1916 revision of the federal act removes the question by providing

"That the term dividends as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint stock company, association, or insurance company out of its earnings or profits accrued since March 1, 1913, and payable to its shareholders whether in cash or in stock of the corporation, joint stock company, association, or insurance company, which stock dividend shall be considered income to the amount of its cash value."

The effect of this amendment is to limit the taxation of increase in capital assets or distribution of surplus to such part of the fund as accrued or was earned subsequent to the enactment of the 1913 law.

STOCK DIVIDENDS

A closely related question arises in the case of the distribution of surplus in the form of stock dividends on which the authorities are also divided. The United States Supreme Court has uniformly held that stock dividends are not income for the reason that after a pro rata distribution of such dividends a stockholder has no greater interest in the corporate assets than he had before, and that in consequence, receipt of the stock dividend does not represent either profit or income, Gibbons vs. Mahon, 136 U. S., 549; D'Ooge vs. Leeds, 176 Mass. 558. The Supreme Court of New York, on the other hand, held in the case of Lowry vs. Farmers L. & T. Company, 172 N. Y. 137, and subsequent decisions, that a stock dividend is income to the stockholder when received, and the supreme court of Wisconsin followed the New York rule and criticized the federal authorities in Soehnlein vs. Soehnlein, 146 Wis. 330. It was urged in the latter decision that if the surplus had been distributed in the form of cash it would be clearly taxable and that there is no substantial difference between a distribution of surplus in cash and in the form of stock dividends; that the issue of the stock dividend decreased the net assets of the corporation in the same proportion that the stockholders' interest was increased. Both New York and Wisconsin adopted this rule with

full knowledge of the contrary rule in the federal courts and the conflict is irreconcilable. Of course the federal decisions control in the administration of the federal income tax law, but the state courts are at liberty to follow whichever of these rules they deem advisable in the construction of their own laws. The federal rule is probably modified by the 1916 amendment above quoted, declaring stock dividends taxable to the same extent and under the same conditions as if the distribution were made in cash.

INHERITANCES AND ANNUITIES

A further question arises as to whether irregular receipts, such as gifts, inheritances, annuities and the proceeds of life insurance and endowment policies, are taxable as income. Logically the answer would seem to depend upon the question whether such receipts represent a return of capital previously invested or not, but this distinction has not always been observed either in framing or construing income tax laws. Annuity and endowment payments have been held taxable under the English income tax act, but legacies have been treated as an addition to capital, Knowles vs. McAdam, L. R. 3 Ex. Div. 23. The income tax law of Hawaii includes "money and the value of all personal property acquired by gift or inheritance," except when otherwise taxed as such. The Wisconsin law as first enacted had a similar provision, but by later amendment gifts and inheritances are exempt. Both the federal and Massachusetts income tax laws expressly exclude inheritances and bequests from the operation of the law, and this is

believed to be the general rule. Such irregular and sporadic receipts are treated as additions to capital instead of income. To the extent that purchased annuities and life and endowment insurance involve the expenditure of capital, the proceeds thereof should not be taxed, and this is the tendency of modern legislation.

The rule prescribed by the Internal Revenue Department in administering the present income tax law is:

"The amount paid under a life insurance endowment or annuity contract is not income when returned to the person making the contract, either upon the maturity or surrender of the contract; but the amount by which the sum received exceeds the sum paid and coming into the hands of the person making the contract and payment is income."

The Wisconsin income tax act provides that "endowments or other insurance paid to the insured in his lifetime shall be taxable upon the excess received over the amount paid for the insurance." In other words, the tax applies only to the profit element of the transaction. The Massachusetts law has no express provision on the subject and no administrative rule has thus far been published.

NET INCOME

As the basic principle of an income tax is to graduate the burden according to the taxpayer's ability to pay, it necessarily follows that the tax should be computed according to his net income. Such ability depends upon his gains and profits for the year and

these cannot be measured by his gross income until compared with the expense involved in producing it. Accordingly all modern income tax laws use net income as the basis of the tax and this is arrived at by deducting from the gross income for the year covered by the return the ordinary expenses incurred in producing it. Broadly speaking, these expenses include the cost of labor, material and goods, freight, cartage, rent, taxes, insurance, interest, depreciation and repairs and all other expenses necessarily incident to carrying on the business. Bad debts previously reported as income and other losses arising out of the business conducted are also deductible but no deductions are allowed as compensation for personal services of the person reporting, nor for expenses of a personal character. as those are covered by his exemptions. Corporations are allowed to deduct reasonable salaries paid to officers in determining their net income, but the latter are taxable upon such salaries in their individual capacity.

As a condition of deducting wages and salaries under the Massachusetts and Wisconsin laws, the employer is required to report the names and amounts paid to each person employed by him, and the same rule applies in the case of payments for interest and rent. Failure or refusal to furnish such list will defeat the deduction. The purpose of this provision is to serve as a check on the persons receiving the payment in the assessment of their income by taxing officials. It is designed as a substitute for the principle of collection at the source prescribed by the English and Federal income tax laws.

LOSSES

As a general rule deductions for losses are confined to those incurred in the trade or business producing the income and such as result from physical causes. The Federal income tax act provides for the deduction of "losses actually sustained during the year incurred in his business or trade or arising from fires, storms, shipwreck or other casualty and from theft, when such losses are not compensated for by insurance or otherwise." The provisions of the Hawaiian and Wisconsin laws are not thus restricted, but considering their purpose, namely, to impose a tax on income, not on property or capital, it is believed that they should have the same construction.

Black on Income Taxes, section 304, says: "Apparently the legislative purpose was to include those losses which are incident to the business out of which the taxable income is produced or such as involve the destruction or impairment of property employed or capital invested in that business." This distinction is important where the entire income is not subject to the tax, as under the Wisconsin law. To meet this situation the Wisconsin Tax Commission adopted the following rule:

It is believed that the legislature intended the provisions of the law relating to the assessment of income and deduction of losses to be correlative, and that a loss resulting from a given transaction should not be allowed as a deduction unless the profit therefrom, if one had been realized, could be taxed as income. This rule prohibits the deduction of losses resulting from business transacted without the state the profit from which could not be taxed if one had been realized.

The present Federal income tax act authorizes the deduction of losses resulting from transactions not connected with the business or trade producing the income but only to the extent of the income derived therefrom. Mere fluctuation in the value of property is neither taxable as income nor deductible as loss until the amount is determined by sale or other final disposition of the property, even though evidenced by book entry. The loss is not "actually sustained" within the meaning of the law until the amount has disappeared from the assets of the person reporting as the result of a completed, closed transaction, Foster's Income Tax, Sec. 68.

INTEREST

Natural persons are generally allowed full deduction of all interest paid by them during the year covered by their returns. Under the Federal corporation act of 1909, deduction of interest was limited to the amount payable on an indebtedness not exceeding the capital stock of the corporation. The Wisconsin law contains a similar provision. The purpose of this limitation was to prevent the practice of low capitalization and large bond issues and the consequent distribution of earnings in the form of interest not subject to the tax, and it was sustained on that ground in the case of Anderson vs. 42 Broadway, 239 U. S. 69. The 1916 revision of the Federal act modifies this limitation by permitting deduction of interest on an indebtedness equal to the paid up capital stock outstanding at the close of the year and one-half of its interest-bearing indebtedness, with

the further proviso that full deduction shall be allowed to corporations dealing in securities pledged as collateral.

As interest is a necessary outlay for those doing business on credit it would seem proper to allow full deduction of all interest paid on indebtedness incurred in carrying on the business producing the income as in the case of insurance and taxes.

DEPRECIATION

All income tax laws provide for deduction of a reasonable allowance for depreciation of the property used and employed in producing the income. The amount of such depreciation depends upon the nature and use of the property and its probable life. The underlying idea is to provide a fund sufficient to replace the property or its original cost when it becomes unfit for use, so as to leave the capital unimpaired. In addition to allowance for the ordinary use and wear and tear of property the Federal income tax act, as revised in 1916, further allows for exhaustion "In the case of mines a reasonable allowance for depletion thereof, not to exceed the market value in the mine of the product which has been mined and sold during the year for which the return is made, under rules to be prescribed by the Secretary of the Treasury," but when such allowance equals the capital originally invested no further depreciation is permitted. No deduction for exhaustion or depletion in the case of mineral properties was provided by the Federal corporation act, under which the decision in the case of Von Baumbach vs. Sargent Land Co.,

supra, was rendered, and therefore the rule laid down in that case is not authoritative under the present Federal income tax law.

DEDUCTION OF DIVIDENDS

In the case of dividends received from corporations it is common to relieve the stockholder from the tax to the extent that the corporation has paid it. The payment of such tax by the corporation operates to reduce the earnings available for distribution, and to charge the stockholders again would be in effect double taxation. Both Federal and State statutes provide against this result. Under the Federal law the corporation is charged with the normal tax only and stockholders receiving dividends are entitled to an abatement or deduction to that extent. Under the Wisconsin law the entire tax is charged to the corporation and therefore the dividend passes tax free to the stockholder. The obvious purpose of this statute is to prevent double taxation and no difficulties arise where the entire income of the corporation is taxed; but where only part of the corporate income is taxable it becomes necessary to prorate the deduction so as to relieve the stockholder from payment on only that portion of his dividend which has already been taxed to the corporation.

HOLDING COMPANIES

Under the present Federal law the right to deduct dividends is limited to individual stockholders and is not allowed to corporations owning stock in other corporations known as holding companies. The Wis-

consin law has no such limitation and authorizes the deduction of dividends received from corporations "the income of which shall have been assessed under the provision of this act." When the parent corporation distributes a dividend to a corporation stockholder the deduction is allowed in full, but when the latter corporation in turn distributes the same income to its stockholders a question has arisen as to whether the deduction should be allowed. While the Wisconsin law does not in terms confine the deduction to dividends received from a corporation which has actually been taxed, it is believed that it should receive that construction. Accordingly, the Federal rule has been followed in this respect and a case is now pending in the Wisconsin supreme court involving the validity of such an assessment.

EXEMPTIONS

When net income is determined, as above outlined, the rate is seldom applied to the entire amount. By common usage some portion of the income is relieved from the tax by means of an exemption or abatement. These exemptions vary in form and amount in different countries and sometimes in different parts of the same country, according to industrial and economic conditions, the prevailing standard of living, and the nature and source of the income taxed. But they all agree on the basic principle of excluding such part of the net income from the operation of the tax as is deemed "equivalent to that needed to support a family in the very lowest scale of decent subsistence,"

commonly called the "minimum of subsistence," Seligman on Income Tax, p. 27. Obviously it would be both useless and illogical to require the payment of a tax from a person whose income is not sufficient for his own support and who may in turn become a charge upon the public. Accordingly the common practice is to exempt from the operation of the law either a uniform part of the net income of all taxpayers or varying amounts graduated according to the size of the income or the source from which derived. A flat exemption is the common practice in the United States, while in England and other European countries the system of graduated exemptions or abatements prevails.

The Federal income tax law provides a uniform exemption of \$3,000 for an unmarried adult and \$4,000 for husband and wife, without additional allowance for children or dependents. The exemptions under the Wisconsin law are \$800 for unmarried adults, \$1200 for husband and wife, \$200 additional for each child under 18 years of age, and a like amount for each dependent supported by the taxpayer. The general exemption under the Massachusetts law is \$500 for husband or wife and \$250 for each child under 18 years of age, and the same amount for dependents, but in no case to exceed \$1,000. The graduated principle is introduced by denying exemption altogether in the case of income derived from intangibles, except where the aggregate income is less than \$600, in which case an exemption of \$300 is allowed, and by allowing an exemption of \$2,000 in the case of income derived from professions, employ-

ments, trade or business. Substantially the same result is reached by varying the tax rate on income derived from different sources.

While both exemptions and rates under the English income tax law are annually revised by parliament, by common practice an exemption of 150 pounds, or about $750 in United States money, has been allowed in times of peace. Rates and exemptions are further modified as to income derived from different schedules under the English law. An exemption of $1,000 is allowed under the Virginia and Hawaiian income tax laws and $3000 under the Oklahoma law. The French income tax act, adopted by the Chamber of Deputies in 1907, further varied the exemptions according to the cost of living in different districts, thus higher exemptions were allowed in the districts containing the larger cities like Paris and Lyons than in villages and rural districts.

As corporations have no physical needs and are not subject to the infirmities of natural persons, no exemptions are allowed to them, and the same is true of partnerships when taxable as such. Nearly all income tax laws exempt the income of charitable, educational, religious, scientific, civic and like organizations not conducted for pecuniary profit.

In general it may be said that exemptions in the United States are more liberal than those allowed in foreign countries. This results from the higher standard of living among the industrial classes in this country and the greater purchasing power of the monetary unit in Europe. The practice of granting

exemptions was sharply criticised during the early period of income taxation, but exemptions have become a fixed feature of all modern income tax laws and if reasonable in amount are generally approved by present day economists. The balance remaining after deducting expenses and exemptions from the gross income for the year, represents the taxable income or the amount to which the rate is applied.

RATE OF TAXATION

This taxable income may be all subjected to the same rate, in which case it is said to be proportional, or the rate may vary according to the source or amount of the income, when it is said to be progressive. The proportional rate was common in early income tax laws, but is gradually giving way to a progressive rate graduated according to the size of the income taxed; and in many cases the rates also vary according to the nature of the income or source from which it is derived. A common practice is to prescribe a base rate for all incomes below a given amount, say $1,000, and increase this rate by steps of fixed amounts of taxable income until a maximum is reached. Thus the rate under the Wisconsin income tax law is fixed at one per cent. on the first thousand dollars of taxable income and increases by steps of one-quarter of one per cent. for each additional thousand until the fifth thousand dollars is reached, and then by steps of one-half of one per cent. up to $11,000, when a flat or proportional rate of six per cent. applies.

The base rate under the Federal income tax of 1916 is two per cent. on all taxable income, with an additional or supertax of one per cent. on taxable income between $20,000 and $40,000; two per cent. between $40,000 and $60,000; three per cent. between $60,000 and $80,000; four per cent. between $80,000 and $100,000; five per cent. between $100,000 and $150,000, and so continuing by increasing steps until a 13 per cent. supertax is imposed on taxable income exceeding $2,000,000. The aggregate rate, therefore, ranges from a minimum of two per cent. on taxable income below $20,000 to a maximum of 15 per cent. on income exceeding $2,000,000. Both rates and abatements under the English act vary from year to year with the revenue demands of the empire. For several years prior to the commencement of the present war the rates averaged about one shilling on the pound, or five per cent., except as modified by abatements. Since the commencement of the war the progression has been accelerated and the rates increased not only in England but in all the belligerent countries, and now reach as high as 25 or 40 per cent. on large incomes in certain lines of business.

The British law has always differentiated between earned and unearned incomes, applying a higher rate to the latter than to the former. Earned income involves the element of personal effort or exertion, while unearned, or, as Gladstone called it, "lazy" income is the product or yield of property or business. Accordingly the rate applied to income from real estate, trade or commerce is higher than that applied to salaries and wages derived from personal effort.

The same distinction is observed in the recent Massachusetts income tax act, which prescribes a rate of six per cent. on income from intangibles, as compared with one and one-half per cent. on compensation for personal services and income derived from trade.

In early discussions of the income tax progressive rates were severely criticised, but this opposition has gradually subsided and practically every modern income tax law embodies this principle. The decisions of the United States supreme court in the case of Magoun vs. Illinois T. & S. Bank, 170 U. S. 283, upholding a graduated inheritance tax law, and the more recent case of Union Pacific vs. Bushaber, 240 U. S., upholding the income tax law of 1913, fully established the validity of graduated rates. The practice is justified on the ground of the relatively greater ability and lesser sacrifice of those receiving large incomes to contribute to public support than those whose incomes are close to the minimum of subsistence. The widow's mite still involves more sacrifice than the rich man's largess, "for he pays out of his abundance but she out of her want."

ADMINISTRATION

One of the most important features of an income tax law is the machinery provided for its administration. Local officers have the advantage of more intimate acquaintance with taxpayers and of the probable amount of their income, but the grade of ability available is generally of a lower order and administration is likely to suffer from weakness and

favoritism. Satisfactory results have been obtained from a combination of the two, as in England and Germany, where local officers make the initial list, but their assessments are subject to supervision and review by central authority. In England local magistrates make the preliminary assessment under the supervision of a surveyor of taxes, but their work is subject to review by Assessors for Affairs of Taxes and the Land Tax Commissioners appointed by the crown. A similar system prevails in Germany, but in both cases the supervision and final determination of assessments are under the control of central authorities. Administration of all our Federal income tax laws has been vested in the Internal Revenue Department, representing a completely centralized administration.

All experience demonstrates the futility of committing the administration of income tax laws to locally elected officers and confirms the necessity of strong centralized supervision. The early state income tax laws of this country were administered by the property tax assessors and the result proved very unsatisfactory. The practical failure of all state income tax laws prior to that of Wisconsin, enacted in 1911, is traceable to this defect.

Administration is further differentiated according as the taxpayer is authorized to determine his own income or is assessed by officers appointed for the purpose. Voluntary disclosure, subject to review, is the prevailing system in England, while Germany is a striking illustration of official assessments. Under the Federal law taxpayers are required to make full

disclosure of the amount and sources of their income on forms prescribed by the Revenue Department. The same practice prevails in Wisconsin and under the recent Massachusetts law, but the returns so made are subject to audit and final assessment by officers chosen for the purpose. Penalties are prescribed for failure or refusal to make return, and false or fraudulent statements are subject to punishment by fine or imprisonment.

Under the English system the principle of collection at the source is widely utilized and our Federal income tax law embodies the same principle. Under this system fiduciaries and other persons making substantial payments in the form of salaries, interest, dividends, rents and the like are required to withhold the tax chargeable to the recipient and pay the same to the government. As the taxpayer's income from other sources and the amount of his exemptions must be known in order to compute the tax accurately, this provision greatly complicates administration and imposes a considerable burden upon fiduciaries and employers of labor. As above pointed out, the Wisconsin and Massachusetts laws substitute information at the source for collection at the source as a condition of securing the deduction. The purpose is the same in each case, namely, to insure full payment of the tax to the public. It is believed that the system of information at the source is simpler and quite as effective as collection at the source, while it avoids many complications which the latter involves.

COLLECTION

When the tax is finally computed the collection is usually made in the same manner as in the case of other taxes. Where the proceeds are designed for the central government, payment is made to the national treasury through its subordinate branches and no distribution is required. If, however, the tax is designed for local purposes, as in Wisconsin, it must be distributed among the districts from which the income was received. As data for this purpose must be disclosed in the return the forms required are necessarily more complicated than in the case of a national tax.

OPERATION OF INCOME TAX

The conventional criticism of the income tax is that it is all right in theory but will not work in practice. If this criticism is well founded it constitutes a fatal objection to this form of taxation. In last analysis a fiscal system must be tested by results, and the important question is how the income tax actually operates in practice. The first and most obvious test of a tax system is its power to produce revenue, and the income tax has completely met this test. This is shown by the fact that the yield of the tax in England and Germany before the present war broke out exceeded $200,000,000 annually in each country. The assessment of 1915 income by the Internal Revenue Department at the relatively low rates prescribed by the act of 1913 resulted in a tax of $124,937,252. In Wisconsin the assessment of incomes for the same year produced a tax of $5,344,303. It is estimated

that the average annual income of the people of the United States from all sources is over \$30,000,000,000 and that twenty per cent. of the heads of families receive forty-seven per cent. of this amount and that two per cent. of them receive more than twenty per cent. of it, King's Wealth and Income, 132. The Internal Revenue Department reports that one hundred twenty persons in the United States received an income of more than \$1,000,000 each in 1915 and that the aggregate taxable income assessed for that year was \$8,703,068,389. These figures amply demonstrate the possibilities of this form of taxation as a revenue producer.

A TAX ON WEALTH

A study of the returns under income tax laws conclusively shows that the income tax is a tax on the rich and well-to-do. The liberal exemptions allowed by the Federal law exclude the great bulk of the population from its operation. According to the report of the Internal Revenue Department only about one-half of one per cent. of the population is subject to the tax. In Wisconsin, with lower exemptions, less than three per cent. of the population come within the law. Further analysis of the returns indicates that the limited number receiving large incomes pay most of the tax. Thus 329 out of a total of 366,443 persons assessed under the Federal income tax law in 1916 paid about one-fifth of the total tax. In Wisconsin 62 persons receiving an income of over \$50,000 each paid twenty-three per cent. of the tax assessed against individuals, and 14 out of an aggregate of

62,272 taxpayers representing only one-two-hundredth of one per cent. of the total number paid over twelve per cent. of the tax. In the county of Dane, in which the capital is located, three individuals receiving an income of over $25,000 each paid one and one-half times as much tax as the 2,250 persons having less than $1,000 income apiece.

Where the earnings of corporations are assessed at the full progressive rate as in Wisconsin, they pay the bulk of the tax. The aggregate tax assessed under the Wisconsin law on 1915 income was $5,344,-393, and of this amount corporations were assessed for $2,724,466, or seventy per cent. of the total. While corporations paid only the normal rate of one per cent. prescribed by the Federal law of 1913, their aggregate tax according to the last assessment was $56,993,658, or about forty-five per cent. of the total. If the income of these corporations had been subject to the full tax prescribed for individuals under the same act, the yield would probably have been five times that amount. The total number of corporations assessed in Dane County for income of 1915 was 334, and the total tax thereon $133,939, and one corporation engaged in the production of war material paid $67,642, or more than one-half of this total. As enterprises of this character are generally located in cities, it follows as a corollary that the yield of the income tax is primarily derived from urban centers. The liberal exemptions and relatively small income received by agricultural classes practically exempt them from the operation of the law.

COMPARED WITH PERSONAL PROPERTY TAX

Comparison of the amount of taxes paid by a selected group of taxpayers under the Wisconsin act in 1912 with the personal property tax paid by the same persons in the preceding year clearly shows the superiority of the income tax as applied to certain classes of the community. Thus, 25 lawyers included in this group paid an income tax of $12,360 in 1912 as compared with a personal property tax of $4,237 in 1911; 21 other professional men paid an income tax of $9,137 for that year as compared with personal property taxes of $811 the preceding year; 40 brokers, salesmen and solicitors paid an income tax of $13,974 in 1912, as against a property tax of $1,803 in 1911. And 17 capitalists whose personal property tax was $1,448 in 1911 paid an income tax of $13,233 in 1912. These figures clearly show the unequal operation of the personal property tax and the greater efficiency of the income tax in securing contribution from those who are best able to pay. Many lines of business yielding profitable returns require little property to carry them on. Those engaged in such business enjoy the protection of law and the benefits of government without corresponding contribution to its support. To the extent that the income tax reaches this source of revenue, it operates to equalize public burdens.

OBJECTIONS TO INCOME TAX

Complaint is often heard that the income tax is a class tax for the reason that so small a part of the population pays such a large proportion of the yield. But every other tax is subject to this criticism, in greater or less degree. The general property tax reaches only the comparatively small part of the population owning property. Privilege and occupation taxes apply only to those exercising the privilege or following the particular occupation subject to the law. The inheritance tax is confined to those who die leaving a substantial amount of property, and even the poll tax is limited to male adults of certain ages. The test of a tax is not whether it reaches the entire population but whether it applies equally to all persons similarly situated. The income tax satisfies this requirement by applying the same rate and imposing the same burden upon all persons who have the same income. The fact that those who have large incomes pay a larger tax is readily justified by their greater ability to pay and the greater sacrifice involved in the payment of a tax by those who have small incomes. Moreover, in the face of increasing public expenditure and growing demand for public revenue, it is not apparent why those engaged in business yielding liberal returns should not make corresponding contributions to the support of government. The income tax is the only one that reaches all classes of excess earnings.

Objection is often made that an income tax law is inquisitorial, but so are all tax laws when properly

administered. Under the property tax law the assessor may examine the taxpayer and call his neighbors to testify as to the amount and value of his property. He may even disregard the taxpayer's sworn statement and increase the assessment as justice may require. According to a recent bulletin of the Federal Census Bureau, the cost of government throughout the United States has practically doubled within the last ten years, and there is little to indicate that the maximum has yet been reached. In the face of these mounting public burdens, taxes will be imposed in one form or another, and the public will insist upon the necessary information to measure the amount chargeable to each citizen. Concealment and evasion will not permanently avail. The choice lies between a flexible and adjustable system and a rigid and mechanical one, with a long train of injustice in its wake.

CONCLUSION

The most ardent advocate of the income tax will not claim that it is free from imperfections or that it offers the final solution of all tax problems, but experience has shown that both in theory and in practice it more nearly satisfies the accepted canons of taxation than any other tax. Our review of the subject leads to the conclusion

(1) That the income tax marks the latest step in the evolution of the effort to secure contribution to the support of government in proportion to ability to pay;

(2) That in one form or another it has been incorporated into the fiscal system of every civilized country in the world;

(3) And that in practical operation it has proved an efficient method of raising public revenue at a minimum of hardship to taxpayers;

(4) That it reaches new sources of revenue, takes note of the productiveness of different classes of property, automatically adapts itself to changing conditions and graduates the burden accordingly; and

(5) That as a supplement to other forms of taxation it can be utilized to advantage on either a local or national scale.

Thos. E. Lyons